Rhode Island Public Expenditure Council

Tax Policy Analysis

April 2010

RIPEC

Introduction

Based on Census data, in FY 2007, the most recent year for which nationally comparable data are available, Rhode Island's state and local tax collections amounted to $116.33 per $1,000 of personal income. This amount of taxes paid to support government ranks Rhode Island 15th highest among the 50 states. This effectively means the State's tax collections account for 11.6 percent of personal income, which is higher than the national average as well as Connecticut and Massachusetts. The State's FY 2007 state and local tax burden did, however, represent a slight decrease from its FY 2006 level when state and local tax collections accounted for almost 12 percent of personal income.

In October 2009, the Tax Foundation ranked Rhode Island the 44th worst business climate in the country. This ranking was an improvement from the three years prior when the State had the distinction of having the country's worst business climate. Rhode Island maintained its planned rate reduction in its alternative flat rate income tax system and continued a reduction in the maximum amount of property tax increase. At a time when many states are increasing taxes in response to the economic downturn, Rhode Island has comparatively been able to "hold the line" on taxes.

Over the past few years, the State of Rhode Island has undertaken a review of the State's tax climate and structure. The two significant changes that have come out of these analyses are S 3050, legislation that caps the growth in the property tax levy (as opposed to the levy *or* the rate as in the previous legislation), and the alternative flat rate income tax system. Both of these changes have started to have an effect on the State's relative state and local tax burden as was noted above in the discussion of the State's national rankings.

From June 2008 to February 2009, the Governor's Tax Policy Strategy Workgroup held a series of meetings with the intent of "developing a tax strategy so that Rhode Island's tax structure is a competitive advantage in retaining jobs and recruiting businesses." The group developed a series of proposals that included reforms to the individual income tax, estate tax, business corporation tax, existing credits, and administration of the property tax.

The 2009 General Assembly received the proposals from the Governor and the Governor's Tax Policy Strategy Workgroup and enacted a portion of the recommended changes. These changes include taxing long-term capital gains as regular income, effectively raising the rate on assets held for more than five years from 0.83 percent or 1.67 percent to the tax rates applied to ordinary income. The Assembly also increased the exemption amount for estate tax purposes from $675,000 to $850,000; the exemption amount is set to increase by the CPI each year thereafter. Both changes were effective January 1, 2010.

Due to the current revenue climate, there is ongoing discussion and consideration of new revenue sources. The most recent Revenue Estimating Conference projected a 4.2 percent decline in FY 2010 total general revenues compared to the enacted budget. In the FY 2011 budget submission, the State Budget Office estimates a deficit of $362.2 million in FY 2012. By FY 2015, the State budget Office estimates the State will face a deficit of $535.7 million. However, there is also a need to be aware of how changes to the State's revenue system will impact the overall tax structure and business development, retention and location, as well as the effects changes to revenues will have on individuals.

In the 2010 legislative year, various articles have been introduced that, if enacted, would alter the current tax system in Rhode Island. As part of his budget submission, the Governor has submitted legislation to lower the corporate franchise fee from $500 to $250 and to provide for additional tax credits for job creation. In addition, the Governor has proposed the creation of a small business jobs program credit, the elimination of the motion picture and enterprise zone tax credits and increasing the cap for scholarship contributions.

Other changes that have been discussed include, but are not limited to, freezing the flat tax, eliminating the flat tax, broadening the sales tax base, lowering the sales tax rate, and implementing a new corporate franchise tax that would be similar to a gross receipts tax.

A revenue system includes the entire means by which governments acquire financial resources to pay for public goods and services. While each state makes individual decisions concerning its particular revenue system, a core set of principles has evolved over the years. The relative weight given to any one principle will vary in developing or modifying a revenue system; however, each of these criteria should be considered.

A high-quality state revenue system should:

1. Comprise elements that are complementary, including the finances of both state and local governments;
2. Produce revenue in a reliable manner;
3. Rely on balanced and diversified revenue sources;
4. Treat individuals equitably and minimize regressivity;
5. Facilitate taxpayer compliance;
6. Promote fair, efficient and effective administration;
7. Respond to interstate and international economic competition;
8. Have minimal involvement in spending decisions and any such involvement should be made explicit; and
9. Be accountable to taxpayers.

To reflect the economy of tomorrow and improve Rhode Island's fiscal position, State and local leaders should develop a multi-year strategic tax plan with the objective of:

- Lessening the overall tax burden;
- Ensuring a proper balance between state and local taxes;
- Reducing tax inequities among localities in the State;
- Equitably and efficiently funding public services, particularly education; and
- Improving Rhode Island's competitive position.

In addition to this introduction, this RIPEC report includes the following sections:

How Rhode Island Compares

Overview

According to a 2008 analysis by the Tax Foundation, Rhode Islanders paid $4,533 per capita in state and local taxes in 2008, or 10.2 percent of personal income. This was the 10th highest tax burden in the country when measured as a percentage of personal income. Nationally, taxes per capita totaled $4,283, which was the equivalent of 9.7 percent of personal income. Since 1990, state and local taxes as a share of personal income have declined slightly at the national level and increased slightly in Rhode Island. Of note, Massachusetts ranked 13th highest in the country for taxes as a share of personal income while Rhode Island ranked 16th. Over the next 18 years, Massachusetts has fallen in the rankings to 23rd, while Rhode Island has increased to 10th.

Table 1
State and Local Taxes Per Capita and as a % of Personal Income
How Rhode Island Compares to the New England - FY 1990-FY 2008

	1990			1995			2000			2005			2008		
	Taxes Per Cap	% of PI	Rank	Taxes Per Cap	% of PI	Rank	Taxes Per Cap	% of PI	Rank	Taxes Per Cap	% of PI	Rank	Taxes Per Cap	% of PI	Rank
US Average	$2,023	9.9%	-	$2,499	10.2%	-	$3,110	9.5%	-	$3,732	9.8%	-	$4,283	9.7%	-
Connecticut	$2,796	9.9%	17	$3,911	11.8%	2	$5,084	10.9%	3	$6,184	11.5%	2	$7,007	11.1%	3
Massachusetts	2,472	10.2%	13	3,077	10.6%	11	3,923	9.3%	27	4,722	9.9%	18	5,377	9.5%	23
Rhode Island	**2,101**	**10.0%**	**16**	**2,608**	**10.7%**	**10**	**3,266**	**10.2%**	**10**	**4,394**	**11.2%**	**4**	**4,533**	**10.2%**	**10**

Source: The Tax Foundation

Using data from the Census Bureau, Rhode Island also has one of the highest tax burdens in the country, ranking 15th highest per $1,000 of personal income in FY 2007, the most recent year for which nationally comparable data are available. By comparison, Connecticut ranked 21st and Massachusetts ranked 37th. However, Rhode Island's FY 2007 ranking represents an improvement over FY 2006 when the State's total tax burden was the 10th highest in the country. As in previous years, the high property tax burden is the primary driver behind the State's ranking; in FY 2007, Rhode Island's property tax collections as a percent of personal income ranked the State 5th highest in the country and accounted for over 40 percent of all taxes collected in the State.

Rhode Island and the United States Average

- When all revenues are considered (including intergovernmental transfers, all taxes, charges and miscellaneous revenues, liquor store, insurance trust, utility, etc. revenues), Rhode Island ranked 23rd highest in the country per $1,000 of personal income and 14th highest on a per capita basis.
- Total state and local tax collections in Rhode Island of $116.33 per $1,000 of personal income were 3.1 percent higher than the national average, while per capita tax collections of $4,509 were 5.6 percent higher than the national average.

- Rhode Island's property tax collections were 40.9 percent higher than the national average per $1,000 of personal income and 44.3 percent higher on a per capita basis.
- Conversely, sales tax collections were 19.6 percent lower than the national average per $1,000 of personal income and 17.7 percent lower than the national average per capita.
- Individual income tax collections of $26.38 per $1,000 of personal income were 3.1 percent higher than the national average. On a per capita basis, Rhode Island's individual income tax collections of $1,023 were 5.7 percent higher than the national average of $968.

Table 2
State and Local Revenues Per $1,000 of Personal Income and Per Capita
How Rhode Island Compares to the United States Average - FY 2007

	Per $1,000 of Personal Income				Per Capita			
	US	RI	Rank	% of US	US	RI	Rank	% of US
Selected Tax Revenues								
Property	$33.88	$47.72	5	140.9%	$1,282	$1,850	7	144.3%
Individual Income	25.58	26.38	26	103.1%	968	1,023	17	105.7%
General Sales	26.46	21.28	37	80.4%	1,002	825	30	82.3%
Total State and Local Taxes	$112.79	$116.33	15	103.1%	$4,270	$4,509	12	105.6%
Charges and Misc Revenues	$51.75	$46.26	43	89.4%	$1,959	$1,793	33	91.5%
All Revenues*	$270.85	$273.06	23	100.8%	$10,253	$10,583	14	103.2%

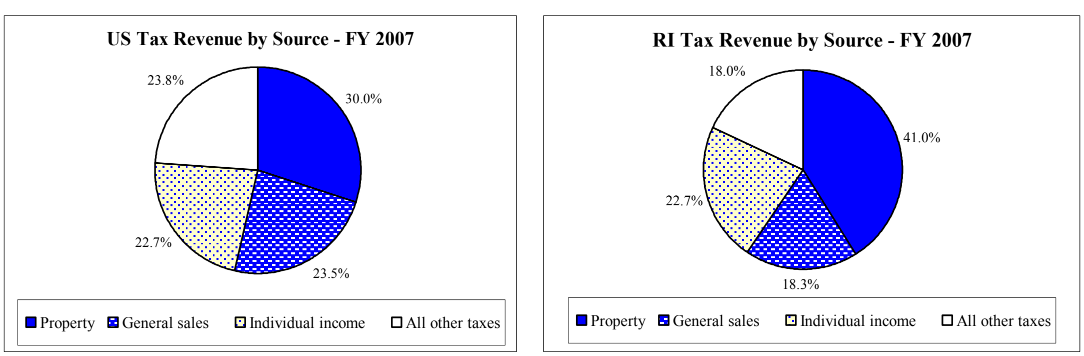
*Revenues include: intergovernmental revenues; all tax revenues; charges and misc. general revenues; utility, liquor store, and insurance trust revenues.

Source: US Census Bureau, Government Finance, FY 2007 Data, Bureau of Economic Analysis for personal income data, RIPEC calculations

Share of Taxes

- As in past years, the majority of Rhode Island's tax burden is the property tax, which accounted for 41.0 percent of all FY 2007 tax collections in the State. In comparison, the property tax represented 30.0 percent of all tax collections nationally.
- Individual income taxes constituted the same share of taxes both in Rhode Island and at the national level (22.7 percent).

Chart 1
Rhode Island and US Tax Revenue by Source - FY 2007



Source: US Census Bureau, Government Finance, FY 2007 Data, Bureau of Economic Analysis for personal income data, RIPEC calculations

- Nationally, there is a greater reliance on sales tax collections to support public services. In FY 2007, general sales tax collections accounted for 23.5 percent of all tax collections in the United States, compared to 18.3 percent in Rhode Island.
- Across the country there is also a greater reliance on all other taxes (including selective sales, estate and gift taxes and severance taxes) than in Rhode Island. These taxes accounted for 18.0 percent of all Rhode Island tax collections and 23.8 percent of all national collections.

Rhode Island and New England

- Rhode Island's FY 2007 tax collections as a share of personal income were the third highest compared to the rest of New England, behind Vermont (5th) and Maine (6th).
- By comparison, Rhode Island had the fourth highest tax burden as a share of personal income in FY 1997, behind Maine (3rd), Connecticut (8th) and Vermont (9th).
- Rhode Island ranked behind Massachusetts (4th), Connecticut (9th) and Maine (16th) with regard to individual income taxes per $1,000 of personal income.
- All New England states rely heavily on the property tax to support public services; the six states all ranked in the top 25 in both FY 1997 and FY 2007. Within the region, Rhode Island's property tax collections of $47.72 per $1,000 of personal income were the third highest (behind Vermont and New Hampshire).
- Conversely, the New England states rely less on general sales tax collections than the rest of the country, with all six states ranking in the bottom 25 in both FY 1997 and FY 2007. Within the region, Rhode Island's general sales tax collections per $1,000 of personal income were the second highest, behind Maine.

Rhode Island's Tax System

Individual Income Taxes

National Overview

Table 3
FY 2007 Total State and Local Government Personal Income Tax Collections

	Per $1k of PI Amount	Per $1k of PI Rank	Per Capita Amount	Per Capita Rank
US Average	$25.58	-	$968	-
Connecticut	$34.02	9	$1,812	3
Maine	31.16	16	1,033	16
Massachusetts	37.10	4	1,772	4
New Hampshire	2.01	42	82	42
Rhode Island	**26.38**	**26**	**1,023**	**17**
Vermont	25.81	29	936	24

Source: US Bureau of the Census; Bureau of Economic Analysis; RIPEC calculations

In FY 2007, individual income tax collections in Rhode Island were $26.38 per $1,000 of personal income ($1,023 per capita). This was slightly higher than the national average of $25.58 per $1,000 of personal income ($968 per capita), and was lower than collections in Connecticut, Massachusetts and Maine. Personal income tax collections in Rhode Island have decreased over the past several years. On a per $1,000 of personal income basis personal income taxes have historically been approximately 10 percent higher than the national average. One should note that Rhode Island implemented a flat tax option for tax year 2006, which will have an impact on current and future income tax collections.

Rhode Island's top marginal rate of 9.9 percent is one of the highest in the 41 states that levy a broad-based income tax. California has a higher top rate of 10.55 percent; however, it is only levied on incomes over $1.0 million, while Rhode Island's top rate is effective on incomes over $372,950. At the same time, Connecticut's top marginal rate is 5.0 percent on incomes over $10,000 and 6.5 percent on incomes over $500,000. Massachusetts has a 5.3 percent tax on income with a 12.0 percent tax on capital gains, as shown on Table 4.

Table 4
2009 Tax Rates

	Marginal Rates and Tax Brackets*	Standard Single	Standard Joint	Personal Exemptions Single	Personal Exemptions Dependents
Connecticut**	3.0% > $0 5.0% > $10,000 6.5% > $500,000	n.a	n.a	$13,000	$0
Massachusetts	5.3% and 12%***	n.a.	n.a.	$4,400	$1,000
Rhode Island****	**3.75% > $0 7% > $33,950 7.75%> $82,250 9% > $171,550 9.9% >$372,950**	**$5,450**	**$9,100**	**$3,500**	**$3,500**

* Single filers

** Exemption value decreases as income increases and is phased out at $37,250 for a single taxpayer; a credit is also offered that is equal to a percentage of tax owed, phasing out as income increases, up to $55,000.

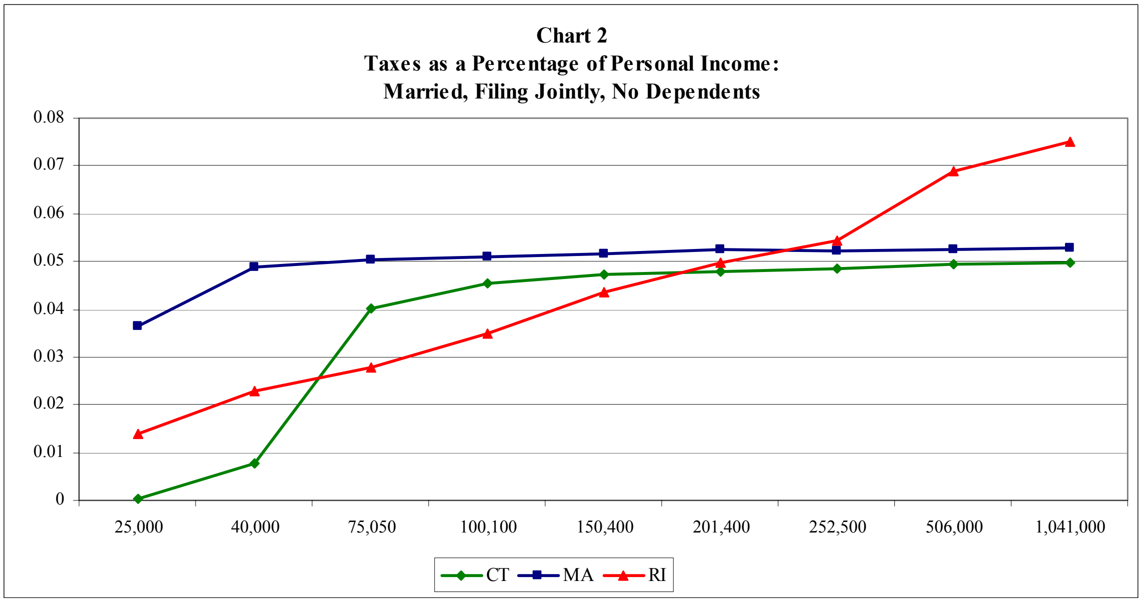
*** The 12% rate applies to short-term capital gains, long- and short-term capital gains

**** 6.5 percent flat tax option; taxpayers calculate and pay the lesser liability.

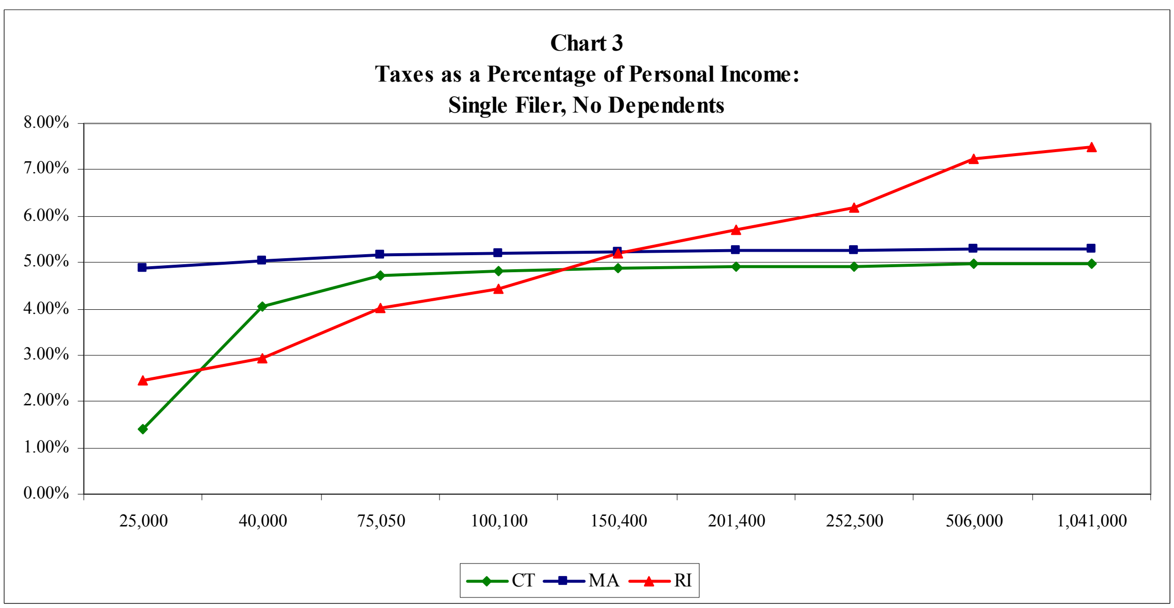
SOURCE: The Tax Foundation

While Rhode Island has a significantly higher top marginal rate than the other Southern New England states, the State's income tax is significantly more progressive than most other states, meaning that lower-income families pay less in personal income taxes as a percentage of personal income than do upper-income families. Compared to Rhode Island, the majority of states have a flatter tax system or a lower income threshold at which income is taxed. Rhode Island's effective tax rate (ETR), that is, the tax burden as a percent of income, is lower than the ETR in either Connecticut or Massachusetts for most taxpayers at lower income thresholds.

The following charts illustrate taxes paid as a percentage of income for various taxpayers in Connecticut, Massachusetts, and the current Rhode Island tax structure. Under the current system this taxpayer (see chart below) would pay more in taxes than similar taxpayers in both Massachusetts and Connecticut at a taxable income level of $252,500



Under the current system, a hypothetical single filer (no dependants) in Rhode Island pays more than Massachusetts and Connecticut at taxable income levels above $150,400.



As noted above, the 2006 Assembly enacted legislation to allow taxpayers to opt for a flat tax of 8.0 percent of adjusted gross income for tax year 2006 in lieu of the current tax in determining tax liability. The 8.0 percent flat tax will decrease by 0.5 percent per year until reaching 5.5 percent for tax year 2011. Filers opting for the flat tax are ineligible for the majority of credits or deductions. This change will reduce the ETR of higher income tax filers as the rate decreases.

Rhode Island Taxes

Based on the most recent "Statistics of Income" for Rhode Island, there were 494,713 tax filers in the State in tax year 2008, shown on Table 5. Those with Federal Adjusted Gross Income (FAGI) over $200,000 accounted for 2.5 percent of all filers, 22.8 percent of statewide (RI) AGI, and 34.5 percent of total tax liability (excluding credits taken). Conversely, tax year 2008 filers with FAGI of $30,000 or less accounted for 47.2 percent of all filers, 10.2 percent of statewide AGI, and 4.0 percent of total net tax liability (excluding credits taken).

Table 5
Analysis of Rhode Island Tax Returns, Tax Year 2008

	<$30,000	**$30,001-$50,000**	**$50,001-$75,000**	**$75,001-$100,000**	**$100,001-$200,000**	**$200,001+**	**Total**
Number of Returns	233,528	85,353	68,180	43,233	51,904	12,515	494,713
% of Total Returns	47.2%	17.3%	13.8%	8.7%	10.5%	2.5%	100.0%
RI Adj. Gross Income*	$2,754.9	$3,337.0	$4,198.5	$3,736.6	$6,872.1	$6,185.6	$27,084.8
% RI Adj. Gross Income	10.2%	12.3%	15.5%	13.8%	25.4%	22.8%	100.0%
Tax Liability ($ millions)							
Regular Tax Liability	$36.0	$75.1	$113.3	$111.7	$259.5	$202.9	$798.5
Flat Tax Liability	0.0	0.0	0.0	0.0	0.0	81.6	81.7
Capital Gains Liability	0.1	0.2	0.4	0.6	2.4	24.1	27.8
AMT Liability	0.0	0.0	0.1	0.2	1.6	8.1	10.0
Other Liability	0.2	0.1	0.1	0.0	0.4	0.1	0.9
Total RI Tax Liability (excl. credits)	$36.3	$75.4	$113.9	$112.5	$264.0	$316.9	$919.0
% of RI Tax Liability (excl. credits)	4.0%	8.2%	12.4%	12.2%	28.7%	34.5%	100.0%
Credits ($ millions)							
RI % of Allowable Fed. Credits	$0.4	$0.5	$0.6	$0.7	$1.4	$1.5	$5.0
Prop Tax Relief Credit	16.5	0.0	0.0	0.0	0.0	0.0	16.5
Out of State Credit**	3.7	9.8	15.0	15.3	38.8	46.7	129.2
Earned Income Tax Credit	7.8	1.2	0.0	0.0	0.0	0.0	9.0
Historic Structures Credit	0.0	0.0	0.0	0.0	0.4	17.8	18.3
Film/TV Credit	0.0	0.0	0.0	0.0	0.1	8.9	9.0
Other Credits	0.1	0.1	0.1	0.1	0.5	5.1	6.0
Total Credits	$28.4	$11.6	$15.7	$16.0	$41.2	$80.0	$192.9
% of Total Credits	14.7%	6.0%	8.1%	8.3%	21.3%	41.4%	100.0%
Net RI Tax Liability	**$7.9**	**$63.7**	**$98.2**	**$96.5**	**$222.8**	**$236.9**	**$726.1**
% of Net RI Tax Liability	**1.1%**	**8.8%**	**13.5%**	**13.3%**	**30.7%**	**32.6%**	**100.0%**
% of RI AGI	**0.3%**	**1.9%**	**2.3%**	**2.6%**	**3.2%**	**3.8%**	**2.7%**

NOTE: Income divisions are based on Federal AGI which may not reflect RI AGI

* Modified Federal AGI

** Out of State and FT Out of State Credits

Source: Rhode Island Statistics of Income, tax year 2008

When credits, which include, but are not limited to, the property tax credit, investment tax credit, historic building tax credit, motion picture tax credit, lead paint credits, and the earned income tax credit, net total tax liability was $726.1 million. Slightly over 41 percent of all tax credits were taken by those with FAGI or $200,000 or more. The second largest share of credits (21.3 percent, or $41.2 million) were taken by individuals with FAGI of $100,000-$200,000, and the third largest share of credits were taken by individuals with FAGI of less than $30,000 ($28.4 million or 14.7 percent).

The majority of credits taken in the lowest income bracket ($16.5 million) were for the property tax relief credit for low-income earners. The out-of-state tax credit was the largest share of total credits taken at all other income levels. Although out-of-state credits accounted for the majority of credits taken by filers with FAGI over $200,000, 34.0 percent of credits taken in this income range were for the historic structures and motion picture tax credits.

In tax year 2008, net Rhode Island tax liability for all filers of $726.1 million totaled 2.7 percent of Rhode Island AGI. Net Rhode Island tax liability for filers with a FAGI of under $30,000 was $7.9 million, or 0.3 percent of Rhode Island AGI, while net liability for filers with FAGI of $200,000 or more was 3.8 percent of modified AGI.

In 2001 the General Assembly enacted a two-year phase-out on capital gains held longer than five years beginning with tax year 2007. In 2007 the General Assembly voted to freeze the capital gains drawdown at 1.67 percent of the federal rate. In the FY 2010 Budget as Enacted, the General Assembly elected to end the preferential treatment of long-term capital gains (assets held longer than five years).

As Table 5 shows, a larger percentage of capital gains income accrues to taxpayers in higher income brackets. In tax year 2008, individuals with incomes of $200,000 or higher incurred 86.8 percent of all capital gains liability while individuals with incomes of $30,000 or less were liable for just 0.4 percent of capital gains liability.

Estate Taxes

The Governor proposed increasing the exemption amount for Rhode Island Estate Tax purposes from the current limit of $675,000 to $1,000,000, effective January 1, 2010. The current exemption amount is one of the lowest in the United States, while the proposed exemption amount would be equal to the Massachusetts estate tax exemption amount. The higher exemption amount would eliminate the payment of estate taxes for 44.8 percent of Rhode Islanders subject to the estate tax at a cost of $1,487,980 in FY 2010.

Table 6
Resident Filer Estate Tax Summary Tax Year 2008

Gross Taxable Estate Value	Number of Returns	% of Total Returns	Estate Taxes Paid	% of Total Estate Taxes
≤ $1,000,000	146	44.8%	$3,237,130	11.1%
≤ $2,000,000	133	40.8%	7,645,185	26.3%
≤ $3,000,000	21	6.4%	2,730,953	9.4%
≤ $3,500,000	8	2.5%	1,638,537	5.6%
> $3,500,000	18	5.5%	13,834,819	47.6%
Total	**326**	**100.0%**	**$29,086,624**	**100.0%**

SOURCE: Rhode Island Division of Taxation

Table 6 shows the number of resident estate tax returns filed and the estate taxes paid by Rhode Island residents in Tax Year 2008 for estates with gross taxable estate values of $1.0 million or less through $3.5 million or more.

The 2009 Assembly increased the Rhode Island estate tax exemption amount from $675,000 to $850,000 for any resident or non-resident who dies on or after January 1, 2010 and adjusted that exemption annually by the Consumer Price Index beginning January 1, 2011. The exemption applies to the net taxable estate value – net taxable estates below the exemption amount are not subject to the tax.

Personal Income Tax Issues
The personal income tax is the largest single source of State general revenues. Therefore, a comprehensive discussion of the State's tax structure cannot ignore issues of fairness, administration, and competitiveness of the State's largest tax generator.

- To improve Rhode Island's personal income tax system, one should consider the following:
  - Economic Competitiveness: A quality tax system should not create barriers that discourage economic activity. The income tax should not be perceived to discourage job creation and investment. Because states have increased the level of competition for economic development, Rhode Island should continue to assess whether the State's personal income tax system encourages or discourages economic expansion and job retention;
  - Equity and Fairness: The personal income tax introduces progressivity into the State's tax system, helping reduce the generally regressive nature of other State and local taxes, particularly the property tax. Therefore, issues of both vertical and horizontal equity must be considered in any reform of the State's personal income tax system;
  - Simplicity: Simplicity is another characteristic of a quality income tax system. Taxes should be easy to calculate and comply with, and easy to administer. It takes a knowledgeable tax practitioner to determine which credits to take and in which order to take them. While some taxpayers have complex filing requirements because of the nature of their income and deductions, the average state tax return should be a fairly simple undertaking. Simplicity is also related to administrative efficiency and effectiveness where tax collections and compliance imposes as little costs as possible on both the State and taxpayer; and
  - Transparency: A key principle of a quality tax system is transparency, including tax rates, income brackets, and personal exemptions that are indexed to an inflation factor. The public should be able to understand how it is being taxed compared to other states. Recently, the Assembly undertook efforts to increase transparency within Rhode Island's income tax system.

- Tax credits in Rhode Island have had a significant impact on State personal income tax revenue collections. There is a need to continue to examine credits to determine if they are meeting their objectives and, if necessary, whether, and how, to modify the credits.

- Any further changes to the capital gains tax should be made with caution, after an examination of the demographic profile of taxpayers who claim capital gains income. As an increasingly larger percentage of capital gains are held by the elderly, who often do not earn wages, the impact of higher capital gains rates may become one of greater importance.

Business Taxes

Overview

On average, corporate tax revenues make up about 7 percent of total state tax revenues. But reliance on corporate taxes differs from state to state, ranging from 2 percent in Hawaii to 27 percent in New Hampshire in 2007. Among the states that tax corporate income, marginal tax rates ranged from 4.63 percent in Colorado to 12 percent in Iowa. The progressivity of the corporate income tax structure also varies. Today, 31 states tax corporate income at a flat rate. The remaining 16 states have multiple tax brackets.

National Rankings

There are several national studies that use various methodologies to measure tax climates or evaluate tax burdens. The methodology used by each study places relative values on different components, such as maximum rates vs. overall burdens, complexity of administration, or total costs to businesses. The chosen methodology reflects the issues that each organization views to be the most important in business-related decisions.

According to a January 2009 Ernst and Young report, businesses currently pay a large portion of Rhode Island taxes. Table 7 shows how Rhode Island compares with a sampling of other states in terms of the amount of business taxes paid as a percent of gross state product (GSP). Based on the report, Rhode Island's business tax burden ranked 11th highest in the nation in FY 2008. Further, the State experienced a 52.7 percent growth rate from FY 2002 to FY 2008, compared to the national average of 45.6 percent. Connecticut saw a 26.5 percent rate of growth while Massachusetts experienced a 41.8 percent increase.

Table 7
Business Taxes
as a Percent of GSP

State	% GSP
Rhode Island	**5.7%**
New Hampshire	5.4%
New Jersey	5.0%
Massachusetts	4.2%
Connecticut	3.7%
Virginia	3.9%
North Carolina	3.6%
Delaware	3.8%
US Average	4.9%

SOURCE: "Total State and Local Business Taxes", January 2009, Council on State Taxation and Ernst & Young

The Tax Foundation ranked Rhode Island's business tax climate as the 44th worst in its *2010 State Business Tax Climate Index*. With the exception of New Hampshire, which ranked 7th, all New England states ranked in the bottom 20 states. There are five major component indexes that comprise the Tax Foundation's State Business Tax Climate Index, including: the Corporate Tax Index (two sub-indexes, one that measures the impact of the rate structure and one that measures the composition of the business tax base); Individual Income Tax Index; the Sales Tax Index; the Property Tax Index; and the Unemployment Insurance Tax Index. The Foundation ranks Rhode Island the 10th highest for tax burden in the nation.

The Milken Institute released a *Cost-of-Doing Business Index* in 2007. The Institute includes a Wage Cost Index, a Tax Burden Index, and Electricity Cost Index, an Industrial Rent Cost Index, an Office Rent Cost Index, and a Cost-of Doing Business Index. Overall, Rhode Island ranked 10th highest in the analysis (indicating that it was the 10th most expensive State in which to do business). Connecticut ranked 5th highest, Maine ranked 19th highest, Massachusetts ranked 3rd highest; New Hampshire ranked 16th highest, and Vermont ranked 11th highest.

Forbes released a *Best States for Business* ranking in 2009. It includes six categories for businesses: costs, labor supply, regulatory environment, current economic climate, growth prospects and quality of life. The index factors in 33 different points of data to determine the ranks in the six main areas. Business costs that include labor, energy and taxes are weighted the most heavily. In that Index, Rhode Island ranked last, compared to 2008 when the State ranked 45th. New Hampshire was the only New England state to rank in the top half of the states in 2009, ranking 19th highest. Connecticut ranked 35th, Maine ranked 41st, Massachusetts ranked 34th, and Vermont ranked 47th.

In *Small Business Survival Index 2009: State Rankings*, published December 2009 by the Small Business & Entrepreneurship Council, Rhode Island ranked the 45th lowest in the country. The report "ranks the 50 states and the District of Columbia according to some of the major government-imposed or government-related costs affecting investment, entrepreneurship, and business. The Index ranks the states according to their public policy climates for entrepreneurship." According to the report, all other New England states ranked in the bottom 25 in the country and, with the exception of New Hampshire, ranked in the bottom ten. Connecticut ranked 40th, Maine ranked 46th, Massachusetts ranked 44th, New Hampshire ranked 33rd, and Vermont ranked 47th.

The surveys noted above demonstrate the perception that Rhode Island is not perceived as a good place to start or grow a business and, while taxes are not the only factor in the studies, they do figure heavily into the State's ranking and are one of the few variables that are within the State's power to change. Regardless of the Index used, Rhode Island tends to rank in the bottom. This was one of the reasons that the Governor had created a Strategic Task Force to look at Rhode Island's tax structure and make it more competitive.

Rhode Island Business Taxes

Table 8
Corporate Income Tax Receipts
$ million

	Amount	% of Gen Revs
2000	$76.3	3.5%
2010*	94.1	3.2%
2011*	100.0	3.5%

Change 2000-2010	
Amount	$17.8
Percent	23.3%

* Based on November 2009 REC

Source: House Fiscal Staff and RIPEC calculations.

In Rhode Island, corporations and businesses, wherever incorporated, deriving any income from sources within Rhode Island or engaging in any activities or transactions within the State for purpose of profit or gain must file taxes. In addition, all corporations, joint-stock companies, and associations incorporated in Rhode Island or qualified to do business in Rhode Island, which must be registered with the Secretary of State, are liable of the franchise tax under Chapter 12 of the Rhode Island General Law. The amount of the franchise tax liability is offset by the amount of corporate income tax paid.

Since July 1, 1989, the corporate income tax rate has been nine percent with a minimum tax of $500 since January 2004. For businesses filing corporate income tax returns, the franchise tax rate is $500 per million of authorized capital stock or $500, whichever is greater. The amount of the franchise tax liability is offset by the amount of Corporate Income Tax paid. Businesses that have not engaged in activities within the state for a tax year pay $500 if capital stock does not exceed $1.0 million and $12.50 per million or fraction of above that first $1.0 million.

In Rhode Island, corporate income tax receipts increased from $76.3 million in FY 2000 to an estimated $94.1 million in FY 2010, increasing by $17.8 million, or 23.3 percent during that time period. In FY 2011 receipts from the business corporation tax are projected to be $100.0 million, accounting for 3.5 percent of all State general revenues.

The majority of filers in Rhode Island pay the minimum tax. In tax year 2008, out of the 48,597 total taxpayers, 45,063 (92.7 percent) paid the minimum tax. Of the minimum filers, the majority (55.2 percent) were organized as S-Corporations, while 12, 233 (25.2 percent) were C-Corporations. The remainder, 6,024 entities (12.4 percent of minimum filers) were organized as LLCs.

Table 9
RI Corporate Filers by Type

	TY 2006		TY 2007		TY 2008	
	Total Filers	% of Total	Total Filers	% of Total	Total Filers	% of Total
Total Taxpayers	49,512	100.0%	49,619	100.0%	48,597	100.0%
Minimum Tax Filers	45,823	92.5%	46,143	93.0%	45,063	92.7%
Breakdown of Minimum Tax Filers:						
LLC Filers	7,417	15.0%	6,621	13.3%	6,024	12.4%
S-Corp Filers	25,318	51.1%	26,861	54.1%	26,806	55.2%
C-Corp Filers	13,088	26.4%	12,661	25.5%	12,233	25.2%
Minimum Tax Filers	45,823	92.5%	46,143	93.0%	45,063	92.7%

SOURCE: RI Department of Revenue; as of March 15, 2010

Tax credits

Many states offer tax credits for job creation, research and development, and investment, and there is frequently debate about the effectiveness of credits as incentives in business location, retention and hiring decisions. Various tax credits are offered to Rhode Island companies, including, but not limited to, the Innovative Technology Tax Credit, Historic Structures Tax Credit, Motion Picture Production Tax Credit, Biotechnology Investment Tax Credit, Enterprise Zone Wage Tax Credit, Investment Tax Credit, Job Training Tax Credit, and the Research and Development Tax Credit.

Changes to Rhode Island Business Taxes

Apportionment: The 2003 Assembly amended the multi-state apportionment formula for manufacturers to double weight the sales factor, with a two-year phase-in with tax years beginning on or after January 1, 2004. In the first year (between January 1, 2004 and January 1, 2005) the weights were 30 percent on property, 30 percent on payroll, and 40 percent on sales. For subsequent tax years, the factors were 25, 25, and 50 percent for property, payroll and sales, respectively. The 2007 Assembly legislation required Rhode Island corporations with transactions outside Rhode Island to add into the sales factor used in the multi-state apportionment formula the gross sales from shipments made from within Rhode Island into states where the corporation is not taxable.

Intangible Addbacks: Another trend in determining tax liability is requiring the addback of certain related-party expenses that were previously used to reduce an entity's taxable income (e.g. a company leasing a trademark or paying a license fee to a subsidiary located in a state without a corporate or personal income tax). Almost half the states have enacted provisions requiring addback of related-party expenses. The 2007 Assembly amended the corporate income tax to require corporations to add back otherwise deductible interest expenses and costs and intangible expenses and costs accrued through transactions with related companies over which they have control.

Combined Reporting: The 2007 Assembly directed the Division of Taxation, with assistance of the Office of Revenue Analysis, to prepare and submit to the Assembly a report concerning the policy and fiscal ramifications of changing the corporation tax and other business income taxes to a combined entity method of reporting. Combined reporting would require entities to file all their associated and subsidiary entities in a single combined report, as they do for federal purposes. The report was submitted to the 2009 General Assembly.

Nexus/"Amazon Law": In 2008, New York signed into law a provision that allowed the State to collect sales tax on sales made through Amazon's independent contractors, despite their lack of physical presence in the State (a qualification for the establishment of "nexus"). However, the Court sided with New York on the basis that physical presence may also be imputed by economic activity based on in-state solicitation of sales by an in-state contractor (independent contractors who advertise on Amazon) on behalf of an out-of-state retailer (Amazon). Other States have followed suit and have passed similar laws. The 2009 General Assembly passed a version of the Amazon Law.

Business Tax Issues

- Over the past years, businesses in Rhode Island have borne an increased share of the growth in the overall state and local tax burden;

- Changes to the business taxes should be considered in the context of the long-range economic policy objectives of the State;

- The impact of the continued shifting of the property tax burden to commercial and industrial property and the impact on Rhode Island's ability to attract business, especially in the State's urban core cities, should be carefully examined;

- Differential tax rates on businesses that provide similar or the same goods and the erosion of horizontal equity as providers diversify the services offered should be analyzed; and

- The impact of the State's high corporate income tax rate on business location decisions should be evaluated.

Sales Taxes

National Overview

In FY 2007, general sales tax collections in Rhode Island were $21.28 per $1,000 of personal income. This was 19.6 percent lower than the national average of $26.46 per $1,000 of personal income. On a per capita basis, Rhode Island general sales tax collections were $825, compared to $1,002 per capital nationally. All six New England states had lower general sales tax collections compared to the national average by both measures. Of the five New England states that levy a general sales tax, Massachusetts had the lowest general sales tax collections on a personal income basis, while Vermont had the lowest on a per capita basis.

Table 10
FY 2007 Total State and Local Government General Sales Tax Collections

	Per $1k of PI		Per Capita	
	Amount	**Rank**	**Amount**	**Rank**
US Average	$26.46	-	$1,002	-
Connecticut	$16.27	41	$867	27
Maine	24.20	29	802	33
Massachusetts	13.26	45	633	41
New Hampshire	-	47	-	47
Rhode Island	**21.28**	**37**	**825**	**30**
Vermont	15.09	42	548	45

Source: US Bureau of the Census; Bureau of Economic Analysis; RIPEC calculations

General state sales taxes across the country range from 2.9 percent in Colorado to a high of 7.25 percent in California. Five states, Alaska, Delaware, Montana, New Hampshire and Oregon, have no state sales tax. Rhode Island's rate of 7.0 percent is the second-highest rate in the country, along with Indiana, Mississippi, New Jersey and Tennessee. However, 13 states have a combined state and local rate of 7.0 or greater, and when local taxes are considered, sales taxes range from a low of 1.45 percent in Alaska, which has no statewide sales tax, to 12.0 percent in Alabama. Rhode Island does not currently allow municipalities to levy a local-option sales tax. Rhode Island also collects an additional 1.0 percent consumption tax on meals and beverages consumed on premises, which is returned to cities and towns.

Table 11
State and Local Sales Tax Rates

	State	Local Range		State	Local Range		State	Local Range
Alabama	4.00%	0-8%	Louisiana	4.00%	0-6.75%	Ohio	5.50%	0-2.25%
Alaska	-	0-7.5%	Maine	5.00%	-	Oklahoma	4.50%	0-6%
Arizona	5.60%	0-5.5%	Maryland	6.00%	-	Oregon	-	
Arkansas	6.00%	0-5.5%	Massachusetts	6.25%	-	Pennsylvania	6.00%	0-1%
California	7.25%	0-1.5%	Michigan	6.00%	-	**Rhode Island**	**7.00%**	**-**
Colorado	2.90%	0-7%	Minnesota	6.50%	0-1%	South Carolina	6.00%	0-2%
Connecticut	6.00%	-	Mississippi	7.00%	0-0.25%	South Dakota	4.00%	0-2%
Delaware	-		Missouri	4.23%	0.5-4.75%	Tennessee	7.00%	1.5-2.75%
Florida	6.00%	0-1.5%	Montana	-		Texas	6.25%	0-2%
Georgia	4.00%	1-3%	Nebraska	5.50%	0-2%	Utah	4.65%	1-3.6%
Hawaii	4.00%	0-.5%	Nevada	6.50%	0-1.25%	Vermont	6.00%	0-1%
Idaho	6.00%	0-3%	New Hampshire	-		Virginia	5.00%	-
Illinois	6.25%	0-4%	New Jersey	7.00%	-	Washington	6.50%	0.5-2.5%
Indiana	7.00%	-	New Mexico	5.00%	0.125-3.438%	West Virginia	6.00%	-
Iowa	6.00%	0-2%	New York	4.00%	0-5%	Wisconsin	5.00%	0-1%
Kansas	5.30%	0-3%	North Carolina	4.25%	2-3%	Wyoming	4.00%	0-3%
Kentucky	6.00%	-	North Dakota	5.00%	0-2.5%			

SOURCE: Rhode Island Department of Revenue

NOTE: The local range shows the minimum and maximum local option sales tax that is added to the state rate. Thus, in Alabama, the combined state and local rate ranges from 4.0 percent to 12.0 percent. Not all counties levy a local option in states that allow local option taxes.

When comparing rates, one must also look at the impact of exemptions to the sales tax code. Rhode Island exempts a number of categories from the sales tax, including food (excluding food intended for immediate consumption), prescription drugs, non-prescription drugs, services, clothing, and footwear. In total, there are 72 categories that are considered "tax preference items" as of publication of the 2008 tax expenditure report. The Department of Revenue estimates that these exemptions account for approximately $625 million in lost revenue. As of September 2008, 15 states tax food (or allow the application of a local-option sales tax), 35 tax over-the-counter drugs and 37 tax clothing (NOTE: of the eight states that exempt clothing, all include caveats).

Table 12
State and Local Sales Tax Exemptions

	C	F	NPD		C	F	NPD		C	F	NPD
Alabama	T	T	T	Louisiana	T	E	T	Ohio	T	E	T
Alaska	-	-	-	Maine	T	E	T	Oklahoma	T	T	T
Arizona	T	E	T	Maryland	T	E	E	Oregon	-	-	-
Arkansas	T	3.00%	T	Massachusetts	E	E	T	Pennsylvania	E	E	E
California	T	E	T	Michigan	T	E	T	**Rhode Island**	**E**	**E**	**E**
Colorado	T	E	T	Minnesota	E	E	E	South Carolina	T	T	T
Connecticut	E	E	E	Mississippi	T	T	T	South Dakota	T	T	T
Delaware	-	-	-	Missouri	T	1.23%	T	Tennessee	T	5.50%	T
Florida	T	E	E	Montana	-	-	T	Texas	T	E	E
Georgia	T	E	T	Nebraska	T	E	T	Utah	T	1.75%	T
Hawaii	T	T	T	Nevada	T	E	T	Vermont	E	E	E
Idaho	T	T	T	New Hampshire	-	-	-	Virginia	T	2.50%	E
Illinois	1.00%	1.00%	1.00%	New Jersey	E	E	E	Washington	T	E	T
Indiana	T	E	T	New Mexico	T	E	T	West Virginia	T	4.00%	T
Iowa	T	E	T	New York	E	E	E	Wisconsin	T	E	T
Kansas	T	T	T	North Carolina	T	E	T	Wyoming	T	E	T
Kentucky	T	E	T	North Dakota	T	E	T	**TOTAL TAX**	**37**	**15**	**35**

SOURCE: Rhode Island Department of Revenue
C = Clothing, F = Food, NPD = Non-prescription Drugs; T = taxable, E = Exempt

Sales Tax Issues

- Exemptions in Rhode Island's sales tax code have reduced the State's reliance on the sales tax as a revenue source, and increased reliance on other taxes;

- Sales taxes, particularly excise taxes, are among the most regressive forms of taxation. Revisions to the sales tax code should be made with caution and with consideration of the regressive nature of the sales tax;

- Changes to sales taxes should be evaluated in terms of the impact sales tax pyramiding may have on the purchaser; and

- Consideration should be given to the impact of remote sales on main street business and to the efforts made by the Streamlined Sales Tax Project.

Property Taxes

National Overview

Property taxes are, in general, the single largest portion of total tax collections across the New England region and the nation as a whole. However, New England relies more heavily on the property tax to fund local governments than does the rest of the country, in part because the majority of the states do not have, or only limited, the ability to levy a local-option sales tax, and they rely less on fees and other non-tax sources. In FY 2007, property tax collections in Rhode Island were $47.72 per $1,000 of personal income, or 40.9 percent above the national average of $33.88 per $1,000 of personal income. On a per capita basis, Rhode Island property tax collections of $1,850 were 44.3 percent higher than the national average of $1,282 per capita.

Table 13
FY 2007 Total State and Local Government Property Tax Collections

	Per $1k of PI		Per Capita	
	Amount	**Rank**	**Amount**	**Rank**
US Average	$33.88	-	$1,282	-
Connecticut	$43.31	8	$2,307	3
Maine	47.20	6	1,565	10
Massachusetts	35.93	18	1,716	8
New Hampshire	54.39	2	2,220	4
Rhode Island	**47.72**	**5**	**1,850**	**7**
Vermont	54.66	1	1,983	5

Source: US Bureau of the Census; Bureau of Economic Analysis; RIPEC calculations

Rhode Island Taxes

In 2006 the General Assembly passed the "Property Tax Relief Act of 2006", commonly referred to as S-3050. The legislation provided for a cap on the amount the property tax levy can grow annually beginning in FY 2008, changes the criteria for exemptions from the cap, limits the amount of money school committees can request from municipal funds, amended the definition of state mandates, and required the Division of Municipal Finance to conduct a property tax study relating to tax treaties. Table 14 outlines the reduction in the cap.

Table 14
Property Tax Cap

Year	Rate
FY 2008	5.25%
FY 2009	5.00%
FY 2010	4.75%
FY 2011	4.50%
FY 2012	4.25%
FY 2013	4.00%

Source: RIPEC

For FY 2010, the growth in the levy was restricted to 4.75 percent over the year prior. The Division of Municipal Finance notes that if the property cap were applied statewide, the total property tax levy in the State would have been $2,065.0 billion. The actual FY 2010 levy was $2,035.0 billion, a 3.31 percent increase over the FY 2009 levy and a 7.8 percent increase over the FY 2008 levy.

Communities may apply for an exemption to the cap if they experience a loss in non-property tax revenues, the city or town experiences or anticipates an emergency situation which will cause the levy to exceed the cap, if debt service expenditures increase at a rate greater than the levy cap, or if the city or town experiences significant growth that necessitates significant infrastructure or school housing expenditures AND the increase is approved by at least four-fifths of the full membership of the governing body.

In FY 2010, seven communities, Cranston, East Greenwich, New Shoreham, North Providence, North Smithfield, Pawtucket and Woonsocket applied for, and received, permission to exceed the levy cap. Of those seven communities, only four enacted a levy that exceeded the cap, as outlined on Table 15; the average increase was 8.77 percent. Eight communities enacted a levy at the cap, while 27 communities enacted a levy that was below the cap, with an average increase of 1.98 percent.

Table 15
FY 2010 Percent Increase in
Property Tax Levy by Municipality

Below Cap	Rate	At Cap	Permission to Exceed Cap	Rate
Barrington	4.54	Cranston	E. Greenwich	4.92
Bristol	0.07	Foster	New Shoreham	8.61
Burrillville	4.08	Narragansett	N. Providence	13.44
Central Falls	0.71	N. Smithfield	Pawtucket	8.09
Charlestown	3.48	Portsmouth		
Coventry	(0.16)	Scituate		
Cumberland*	(0.64)	Smithfield		
East Providence**	0.05	Woonsocket		
Exeter	0.78			
Glocester	4.30			
Hopkinton	0.91			
Jamestown	0.98			
Johnston	3.02			
Lincoln	2.70			
Little Compton	0.17			
Middletown	1.97			
Newport	3.34			
N. Kingstown	1.16			
Providence	2.43			
Richmond	3.79			
S. Kingstown	1.22			
Tiverton	(1.29)			
Warren	1.88			
Warwick	4.18			
Westerly	0.46			
W. Greenwich	4.71			
W. Warwick	4.67			
Average	**1.98**	**4.75**		**8.77**

* Estimate; final levy will be set in May 2010

** Estimate; final levy will be set June 2010

SOURCE: Division of Property Valuation, "Report on the Property Tax Cap, Fiscal Year 2010", December 31, 2009; RIPEC calculations

Property Tax Issues

- S 3050, legislation that statutorily limits the growth in property taxes, should be kept in place. This legislation closed a major loophole in the State's existing property tax cap by applying the cap to only the levy rather than the rate or the levy and reduced the cap from 5.5 percent to 4.0 percent by FY 2013 in 0.25 percent increments;

- Legislation adopted in 2000 established a statewide standard for local classification schemes. This legislation provides that, upon the completion of any revaluation, a municipality may adopt a property tax classification plan. Local classification plans are limited to four classes of property, and the effective tax rate applicable to any class cannot exceed 50 percent of the rate applicable to any other class; however, exemptions from this law given to various cities and towns have limited its uniform statewide application. Efforts should be made towards standardizing property tax administration throughout the State;

- The current property reappraisal and revaluation schedule should be kept. Legislation passed in 1997 requires a comprehensive revaluation every nine years. In addition, in order to maintain assessments that reflect market changes, the 1997 Act requires cities and towns to conduct a statistical update in the third and sixth year after each revaluation. Decreasing the frequency of property revaluations could result in less equity within and among jurisdictions, reduce the accuracy and reliability of data used to calculate and distribute State aid in the future, and result in credit rating agencies having less "real time" data to use in determining the credit worthiness of Rhode Island's 39 cities and towns; and

- Implement a new education finance system to address the impact of education finance on property tax burdens.

Recent and Proposed Tax Changes

A recent report by the National Conference of State Legislatures notes that the recession has had significant effects on state revenue systems throughout the country. Across the 50 states, estimated FY 2010 net state tax collections (including, but not limited to, personal income taxes, sales and excise taxes, and corporate taxes but excluding local property taxes) increased by $28.6 billion. This increase is the equivalent of 3.7 percent of total FY 2008 collections. As shown in Table 16, the report indicates that 24 states raised taxes by more than one percent of total FY 2008 collections. One state – North Dakota – reduced taxes by more than one percent. New York saw the largest increase in tax collections between the two years; tax collections in the Empire State increased by 10.6 percent of FY 2008 state tax collections.

In Rhode Island, state tax collections increased by 2.1 percent of FY 2008 collections, the 19th highest increase in the country. The largest share of the $59.3 million increase was for the cigarette tax, where collections increased by $31.2 million over FY 2008. Changes to the personal income tax – specifically ending the preferential treatment of capital gains – raised $22.8 million.

Table 16
FY 2010 Tax Changes
Compared to FY 2008 Collections

	2008 Collections ($ millions)	Net Changes* ($ millions)	FY 2010 Changes: Share of FY 2008 Taxes %	Rank	Per Capita $	Rank
Total	$781,787.3	$28,588.5	3.7%	-	$93	-
Alabama	$9,070.5	$200.0	2.2%	18	$42	21
Alaska	8,424.7	33.9	0.4%	29	49	19
Arizona	13,452.1	-13.4	-0.1%	42	-2	45
Arkansas	7,530.5	42.3	0.6%	26	15	27
California	117,362.0	10,980.0	9.4%	2	297	2
Colorado	9,624.6	444.1	4.6%	8	88	13
Connecticut	13,367.6	797.5	6.0%	6	227	4
Delaware	2,931.0	241.6	8.2%	3	273	3
Florida	35,850.0	1,287.2	3.6%	14	69	16
Georgia	18,183.1	-78.5	-0.4%	48	-8	49
Hawaii	5,147.5	198.2	3.9%	12	153	6
Idaho	3,651.9	2.4	0.1%	32	2	33
Illinois	31,564.8	173.0	0.5%	27	13	28
Indiana	14,916.3	214.1	1.4%	23	33	23
Iowa	6,892.0	50.0	0.7%	25	17	26
Kansas	7,159.7	1.9	0.0%	34	1	34
Kentucky	10,056.3	158.8	1.6%	21	37	22
Louisiana	11,003.9	-3.5	0.0%	34	-1	41
Maine	3,681.6	37.9	1.0%	24	29	24
Maryland	16,605.8	-19.5	-0.1%	42	-3	46
Massachusetts	21,836.4	863.7	4.0%	11	131	10
Michigan	25,043.2	0.0	0.0%	34	0	36
Minnesota	18,320.9	28.6	0.2%	30	5	30
Mississippi	6,618.3	161.1	2.4%	17	55	18
Missouri	10,965.2	-42.0	-0.4%	48	-7	48
Montana	2,457.9	0.0	0.0%	34	0	36
Nebraska	4,175.5	0.0	0.0%	34	0	36
Nevada	6,115.6	372.3	6.1%	5	141	8
New Hampshire	2,251.2	93.8	4.2%	10	71	15
New Jersey	30,616.5	1,174.0	3.8%	13	135	9
New Mexico	5,674.5	0.0	0.0%	34	0	36
New York	65,400.4	6,955.2	10.6%	1	356	1
North Carolina	22,781.2	991.1	4.4%	9	106	12
North Dakota	2,312.1	-50.0	-2.2%	50	-77	50
Ohio	27,153.8	535.1	2.0%	20	46	20
Oklahoma	8,484.2	43.4	0.5%	27	12	29
Oregon	7,250.0	576.0	7.9%	4	151	7
Pennsylvania	32,123.7	984.2	3.1%	15	78	14
Rhode Island	**2,761.4**	**59.3**	**2.1%**	**19**	**56**	**17**
South Carolina	8,455.5	-5.5	-0.1%	42	-1	42
South Dakota	1,321.4	1.7	0.1%	32	2	32
Tennessee	11,538.4	176.0	1.5%	22	28	25
Texas	44,676.0	-34.9	-0.1%	42	-1	43
Utah	5,944.9	-5.4	-0.1%	42	-2	44
Vermont	2,544.2	68.5	2.7%	16	110	11
Virginia	18,408.3	5.0	0.0%	34	1	35
Washington	17,944.9	30.8	0.2%	30	5	31
West Virginia	4,879.2	-11.9	-0.2%	47	-7	47
Wisconsin	15,088.7	870.5	5.8%	7	154	5
Wyoming	2,168.0	0.0	0.0%	34	0	36

* Net revenue effect of tax changes for the fiscal year

SOURCE: National Council of State Legislatures, Census Bureau, RIPEC calculations

Another way to look at the FY tax increase is on a per capita basis, which also controls for vast differences in the size of states and state budgets. Nationally, FY 2010 tax increases amounted to $93 per person. New York's FY 2010 tax changes totaled $356 per state resident, the highest in the country, while North Dakota's tax changes reduced tax burdens by $77 per person, the greatest reduction country-wide. Tax changes made in FY 2010 amounted to an additional $56 per person in the Ocean State, the 17th largest increase in the country.

FY 2011 Budget as Proposed

The Governor proposes a number of changes to the State's tax code which, coupled with lowered tax collection estimates from the November Revenue Estimating Conference on which the budget is based, results in a net decrease in tax collections of 6.4 percent when compared to the FY 2010 Enacted Budget. Based on Budget Office documents, the total proposed tax changes would result in a net reduction of revenue of $19.6 million (12.9 percent of the total tax revenue decrease of $151.5 million).

Among the tax changes is a proposal to create a temporary tax cut for small businesses (defined as an entity with at least five, but no more than 100 employees working in Rhode Island and no more than 200 employees worldwide). Eligible entities would receive a $2,000 credit for every eligible employee, hired between July 1, 2010 and December 31, 2011, and employed for at least 18 consecutive months. Eligible employees are defined as those who:

- Have collected unemployment benefits, received TANF assistance, or graduated from college or a technical school within 24 hours of the date of hire; and
- Work a minimum of 30 hours per week, earn no less than 250 percent of the state minimum wage, and are eligible for health insurance benefits provided by the business.

Table 17
Summary of Proposed Tax Changes
Nov. 2010 REC to FY 2011 Proposed Budget

	Change
Personal Income Tax	
Motion Picture Tax Credit Elimination	$1,811,919
Enterprise Zone Tax Credit Elimination	850,000
Small Business Jobs Program Credit	(7,250,000)
Increase Scholarship Contribution Cap	(730,000)
Subtotal: Personal Income Tax	($5,318,081)
General Business Taxes*	
Motion Picture Tax Credit Elimination	$128,769
Enterprise Zone Tax Credit Elimination	150,000
Small Business Jobs Program Credit	(2,750,000)
Increase Scholarship Contribution Cap	(270,000)
Reduce Corporate Minimum Tax to $250	(11,535,750)
Subtotal: General Business Taxes	($14,276,981)
Total	**($19,595,062)**

* Changes affecing both business corporations and insurance companies are included here; Insurance companies will be impacted by changes to scholarship contributions and the motion picture tax credit elimination.

SOURCE: State Budget Office Documents

The budget office estimates that the tax credit would result in a loss of revenue of $10.0 million, the majority of which would be taken against personal income tax liability.

In addition to the small business tax credit, the Governor proposes:

- Eliminating the Enterprise Zone Wage Tax Credit for general revenue savings of $1.0 million. Currently, a credit is allowed against personal income taxes for qualified businesses in a designated Enterprise Zone equal to 50.0 percent of wages paid to new hires with a cap of $2,500 (75.0 percent and a cap of $5,000 if the worker also resides in the Enterprise Zone). To be eligible companies must increase total employment by 5.0 percent over the prior year and increase total wages paid over the prior year's wages paid.
- Eliminating the Motion Picture Production Tax Credit, estimated to generate general revenue savings of $1.9 million. Under current law, companies are eligible to receive a credit worth 25.0 percent of State-certified production costs incurred due to motion picture production activity within the State.
- Reducing the Corporate and Franchise Minimum Tax from $500 to $250. The Budget Office estimates that this would reduce general business tax collections by $11.5 million. Since January 2004, the minimum corporate tax in the State is $500; businesses filing corporate income tax returns pay $500 per million of authorized capital stock, or $500, whichever is greater. This liability is offset by the corporate tax paid each year.
- Increasing the cap on the tax credit available to businesses making contributions to K-12 scholarship organizations from $1.0 million to $2.0 million. This would result in a revenue loss of $1.0 million.

Governor's Tax Policy Strategy Workgroup

In May 2008, the Governor convened a 21-member workgroup with the charge to reform the State's tax structure in order to create a competitive advantage in retaining and recruiting businesses. The workgroup considered three areas of tax policy: state taxes paid by individuals; business taxes; and property taxes. Their recommendations were submitted in a final report in March 20009.

Personal Income Tax

As part of his FY 2010 budget submission, the Governor had proposed a number of reforms to the State's personal income tax system, effective January 1, 2011, based on recommendations made by the Governor's Tax Policy Strategy Workgroup. The proposed reforms would bring Rhode Island's personal income tax system more in line with Connecticut and Massachusetts.

Table 18
Standard Deductions and Exemptions by Filing Status

Filing Status	Standard Deduction	Exemption Type	Exemption Amount
Married Joint/Widow(er)	$15,000	Personal	$2,500
Single/Married Separate	$7,500	Dependent	$2,500
Head of Household	$11,250		

SOURCE: RI Department of Revenue

The reformed personal income tax would be based on the Federal Adjusted Gross Income (AGI) with fewer modifications than currently allowed. Under the proposed tax, the only modifications to AGI would be a standard deduction and personal exemptions indexed for inflation. Income from all sources, including capital gains, would be taxed as ordinary income. Table 18 lists the Standard Deductions and Exemptions by filing status.

The proposal called for reducing the number of brackets to be reduced from five to four and that the rates be reduced as follows:

- $0 - $54,999: 3.5%
- $55,000 - $109,999: 4.0%
- $110,000 - $174,999: 4.5%
- $175,000+: 5.5%

In addition to the above changes, there was a proposal to eliminate most of the current personal income tax credits, effective after December 31, 2010, except for the following four credits:

- Income taxes paid to other states;
- Refundable Earned Income Tax Credit at 15.0 percent of Federal EITC;
- Property Tax Relief Credit; and
- Lead Paint Abatement Credit.

The Governor's proposal also included several carry-forward amounts for certain tax credits used in prior years that could still be used under the reformed personal income tax proposal. They are:

- Historic Structures Tax Credits (HSTC), purchased from developers with qualified projects, could be used against liabilities incurred under the reformed personal income tax proposal. HSTC amounts used would be reimbursed from the HSTC Fund established by the 2008 General Assembly.
- Carry-forward amounts of all other unused credits as allowed under the current law.
- Motion Picture Production Tax Credits for motion picture productions completed prior to January 1, 2011.

According to a report by the Department of Revenue (DOR), 14,421 resident tax filers with itemized deductions and capital gains income would have seen a tax increase under the proposal, while 22,752 resident filers with itemized deductions and capital gains income would have seen their taxes decrease.

General Business Taxes

In an effort to more closely align Rhode Island's business tax burden with that of its neighbors and the national average, there was a proposal to phase-out the business corporation tax by reducing the tax rate from 9.0 percent to:

- 7.5 percent (effective January 1, 2010)
- 6.0 percent (effective January 1, 2011)
- 4.0 percent (effective January 1, 2012)
- 2.0 percent (effective January 1, 2013)

On January 1, 2014 the business corporation tax would be fully eliminated. The estimated cost in FY 2010 was $14.5 million.

In addition to phasing-out the business corporation tax, the Governor proposed to institute a tiered minimum tax based on a corporation's net income, effective January 1, 2014. The proposed payments are shown on Table 19. According to the Division of Taxation, the estimated net revenue gain for FY 2010 would have been $2.2 million

Table 19
Proposed Franchise Tax Payment Structure

Taxable Income	Tax
< $9,999	$450
$10,000 - $24,999	500
$25,000 - $49,999	750
$50,000 - $74,999	1,000
$75,000 - $99,999	1,500
$100,000 - $249,999	2,000
$250,000 - $499,999	3,000
$500,000 - $999,999	5,000
$1,000,000 - $2,499,999	7,500
$2,500,000+	10,000
LLCs & S-Corporations	$450

SOURCE: RI Dept. of Revenue

Sales Tax

There have been several suggested changes to the sales tax including a proposed two-tier sales tax system that would introduce a 1.0 percent tax on clothing, non-prescription medication and food, all of which are currently tax exempt. The taxes are projected to generate roughly $90 million in additional revenue.

There are several other proposals which provide for a reduction in the rate with an increase the base. Currently, Rhode Island imposes a 7.0 percent tax on all sales of tangible personal property and public utilities unless exempted.

Gross Receipts Taxes

In recent months there has been discussion around adopting a modified gross receipts or modified net receipts tax in lieu of the current corporate income tax. Most states levy standard corporate income taxes. Corporate income is generally defined as profit (gross receipts minus expenses). A growing number of states, however, impose taxes on the gross income of corporations with few or no deductions for expenses. Gross receipts taxes tax all business sales with few or no deductions. All transactions are taxed, including intermediate business-to-business purchases of supplies, raw materials and equipment.

According to the Tax Foundation report,*2010 State Business Tax Climate Index*, released September 2009, several states have imposed gross receipts taxes, including Delaware, Kentucky, Michigan, Minnesota, New Hampshire (business profit tax and business enterprise tax), New Jersey, Ohio, Texas, and Washington.

The report of the Governor's Tax Policy Strategy Workgroup, released in March 2009, referenced a 2007 Ernst and Young report, *Rhode Island State and Local Benchmarking Report, Including Analysis of Tax Policy Options* that "examined the feasibility of implementing a gross receipts tax in Rhode Island." Their analysis concluded that a 1.0 percent gross receipts tax with a $600,000 exemption would generate approximately $511.0 million for the State.

One should note that many states only tax gross receipts certain industries, such as utilities, telecommunications and gambling. Rhode Island taxes: public utilities corporations (telecommunications, electric, gas) based on gross earnings; insurance companies based on gross premiums; and health care providers based on gross revenues.